INSOL INTERNATIONAL

FOUNDATION CERTIFICATE IN INTERNATIONAL INSOLVENCY LAW

Module 5B Guidance Text

Cayman Islands

2022 / 2023

CONTENTS

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IN INTERNATIONAL INSOLVENCY LAW

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1. INTRODUCTION TO INTERNATIONAL INSOLVENCY LAW IN THE CAYMAN ISLANDS

Welcome to **Module 5C**, dealing with the insolvency system of the **Cayman Islands**. This Module is one of the elective module choices for the Foundation Certificate. The purpose of this guidance text is to provide:

- a general overview, including the background and history, of Cayman's insolvency laws;
- a relatively detailed overview of Cayman's insolvency system, dealing with both corporate and consumer insolvency; and
- a relatively detailed overview of the rules relating to international insolvency and how they are dealt with in the context of the Cayman Islands.

This guidance text is all that is required to be consulted for the completion of the assessment for this module. You are not required to look beyond the guidance text for the answers to the assessment questions, although bonus marks will be awarded if you do refer to materials beyond this guidance text when submitting your assessment.

Please note that the formal assessment for this module must be submitted by **11 pm (23:00) BST (GMT +1) on 31 July 2023**. Please consult the web pages for the Foundation Certificate in International Insolvency Law for both the assessment and the instructions for submitting the assessment. Please note that no extensions for the submission of assessments beyond 31 July 2023 will be considered.

For general guidance on what is expected of you on the course generally, and more specifically in respect of each module, please consult the course handbook which you will find on the web pages for the Foundation Certificate in International Insolvency Law on the INSOL International website.

2. AIMS AND OUTCOMES OF THIS MODULE

After having completed this module you should have a good understanding of the following aspects of insolvency law in the Cayman Islands:

- the background and historical development of the Cayman Islands insolvency law;
- the various pieces of primary and secondary legislation governing Cayman insolvency law;
- the operation of the primary legislation in regard to liquidation and corporate rescue;
- the operation of the primary and other legislation in regard to corporate debtors;
- the rules of international insolvency law as they apply in the Cayman Islands;
- the rules relating to the recognition of foreign judgments in the Cayman Islands.

After having completed this module you should be able to:

- answer direct and multiple-choice type questions relating to the content of this module;
- be able to write an essay on any aspect of Cayman insolvency law; and
- be able to answer questions based on a set of facts relating to Cayman insolvency law.

Throughout the guidance text you will find a number of self-assessment questions. These are designed to assist you in ensuring that you understand the work being covered as you progress through the text. In order to assist you further, the suggested answers to the self-assessment questions are provided to you in Appendix A.

3. AN INTRODUCTION TO THE CAYMAN ISLANDS

The Cayman Islands is located in the western Caribbean Sea to the south of Cuba and Miami. The territory comprises three islands: Grand Cayman, Cayman Brac and Little Cayman.

Grand Cayman is by far the largest and most populous of the three islands and it is where the Islands' financial services industry is based. The total population of the three islands is approximately 65,000.

3.1 Government

The Cayman Islands is a British Overseas Territory.

England took formal control of the Cayman Islands, along with Jamaica, as a result of the Treaty of Madrid of 1670. The Islands continued to be governed as part of the Colony of Jamaica until 1962 when Jamaica became independent of England.

Since 1962 the Islands have been directly overseen by the UK. The UK Foreign and Commonwealth Office appoints a Governor. The Governor has responsibility for matters such as National Security, Foreign Affairs, Policing, and Immigration.

For all matters not falling within the province of the Governor, the Cayman Islands has a democratically elected local government. The insolvency laws of the Cayman Islands are within the remit of the local government. The local government works closely with the private sector and judiciary to ensure such laws serve the needs of the Cayman Islands financial services industry and the local population.

3.2 Tax and financial services

The Cayman Islands has always been a tax-exempt jurisdiction and has never levied income tax, capital gains tax, or any wealth tax.

This tax "neutrality", coupled with business-friendly laws and a wealth of experienced professionals practicing in Grand Cayman, has been largely credited with helping the Islands to become a thriving offshore financial centre.

At the time of writing there are some 117,000 companies and 35,000 partnerships registered in the Cayman Islands. The Cayman Islands also has its own stock exchange which was opened in 1997.

The US remains the largest source of foreign direct investment followed by Hong Kong, Europe, the Middle East, and Brazil. Outward direct investment from the Cayman Islands goes to jurisdictions such as Luxemburg, the US, Hong Kong, Europe, and the People's Republic of China.

3.3 Tourism

The pristine beaches and coral reefs of all three islands mean that tourism is the second pillar of the Cayman Islands economy. The tourist industry is aimed at the luxury market and caters mainly to visitors from North America.

The Cayman Islands offers the highest standard of living in the Caribbean (reputedly comparable to that of Switzerland).

4. LEGAL SYSTEM AND INSTITUTIONAL FRAMEWORK

4.1 Legal system

As mentioned above, the Cayman Islands has been controlled by England since the 17th century. The Cayman Islands legal system is therefore based on the English model.

In terms of the laws which are in force in the Cayman Islands, the English common law applies save to the extent that it has been modified by Cayman Islands statute.

Although the insolvency laws of the Cayman Islands have been placed on a statutory footing, the legislation is largely inspired by UK legislation. Indeed, the law of England fills any gaps in the Islands' laws.[1]

Since the same basic principles as those underlying the insolvency regime in the United Kingdom apply, the Cayman Islands system will feel reasonably familiar to English and other commonwealth practitioners.

The doctrine of judicial precedent applies in the Cayman Islands therefore case law is important. The similarities between the Cayman Islands and English laws mean that decisions from English courts and other Commonwealth countries, while not binding, are frequently cited in court and are of persuasive authority.

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[1] Grand Court Law (as revised), s 18(2), as seen in *In the Matter of Sphinx Group* [2012 (2) CILR Note 11.

4.2 Institutional Framework

4.2.1 Tiered court system

The Cayman Islands court system is split into three tiers at a local level: the Summary Court, the Grand Court, and the Court of Appeal.

The Grand Court is the court of most relevance to the insolvency practitioner. It is a superior court of record (with powers equivalent to the High Court of England and Wales) and it is where insolvency proceedings are initiated.

The Grand Court administers locally enacted statutes, the common law, and the law of equity of England as well as any imperial legislation which may be passed in London from time to time (although the latter is rare).

The Grand Court has five divisions to manage cases:

- Admiralty;
- Civil;
- Criminal;
- Family; and
- Financial Services Divisions.

It is the Financial Services Division (FSD) that deals with insolvency proceedings.

4.2.2 Substantive law

Until 2008, the law relating to corporate insolvency was derived from three basic sources, namely:

- Part V of the (Cayman Islands) Companies Act (as revised);
- the English Insolvency rules 1986; and
- local case law

Part V of the Companies Act was a direct reproduction of the English Companies Act 1862 (as re-enacted in 1962).

In 2008, however, following a 2006 review by the Cayman Islands Law Reform Commission (LRC) (in conjunction with the private sector), the law was substantially overhauled to bring it up to

speed with the demands of a modern, international business centre and to serve the needs of the financial services industry.

The substantive law is now contained largely in the Companies Act (2022 Revision), the Exempted Limited Partnership Act (2021 Revision) and case law.[2] The relevant sections of these laws will be dealt with below.

4.2.3 Procedural rules

Proceedings in the Grand Court are governed by the Grand Court Rules (as revised) (GCR). These rules contain requirements of general application, for example, the rules for lawful service of documents, the filing of affidavit evidence and so forth.

Proceedings relating to the winding up of companies, however, are specifically governed by the Companies Winding Up Rules 2018 (as amended) (CWR) and certain judge issued Practice Directions (PDs).

4.2.4 FSD

The dedicated Financial Services Division of the Grand Court opened in November 2009. The FSD has greatly enhanced the Cayman Islands as a forum for international litigation and dispute resolution and has resulted in the expedited resolution of complex commercial disputes.

4.2.5 Appeal

Appeals from the Grand Court lie to the Cayman Islands Court of Appeal in the first instance.

Further appeal lies, as appropriate, to the Judicial Committee of the Privy Council in London.

There is also a right of petition to the European Court of Human Rights once all other domestic legal remedies have been exhausted.

4.2.6 Case law and precedent

Decisions of the Grand Court, the Court of Appeal and the Privy Council (on appeals from the Cayman Islands) are available to the public at https://www.judicial.ky/online-public-register-portal-terms.

The Grand Court will generally follow its previous decisions unless convinced they are wrong.[3] Decisions of the higher courts (that is, the Cayman Islands Court of Appeal and the Privy Council) are binding on the Grand Court. Decisions of the courts of England and Wales, and in

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[2] Pre-2008 case law is still cited, where applicable, however care should be taken when referring to such cases for guidance.

[3] For an illustration of this principle in action, in an insolvency context, see *In the Matter of China Shanshui Cement Group Limited* [2015 (2) CILR 255.

appropriate cases other Commonwealth or common law jurisdictions, are highly persuasive and are therefore cited frequently.

4.2.7 Judges

The Grand Court judiciary consists of the Chief Justice and five other full-time judges supplemented by acting judges, sometimes from overseas, as the need arises. Specialist commercial judges sit in the FSD.

4.2.8 Informal restructuring

There is no requirement in the Cayman Islands insolvency legislation for consensual restructuring negotiations to take place before the commencement of the statutory process. Such consensual restructuring negotiations do take place, however, not least because company management and lenders are commonly situated onshore, meaning that contemporary onshore practices influence the offshore strategy.

It is also helpful to be able to demonstrate to the Cayman court, when making an application for restructuring (such as a scheme of arrangement coupled with the appointment of a restructuring officer), that positive, consensual discussions have been taking place prior to the application being made.

4.2.9 Moratorium

Prior to 31 August 2022, if an entity required a moratorium to protect it from creditor enforcement, it needed to be placed into court supervised liquidation (that is, either provisional or official liquidation). If an entity wished to restructure, and needed time to do so, an application would be made to place it into provisional liquidation whilst it sought to negotiate a compromise with its creditors via a scheme of arrangement. This was an artificial, albeit effective, technique to buy the company breathing space. The mechanism carried with it, however, a certain stigma and other negative consequences that flowed from the entity being placed into a liquidation process.

Since the coming into force of the Companies (Amendment) Act 2021, on 31 August 2022, a much more effective procedure is now available to a distressed company. The entity can apply by petition to appoint a company restructuring officer (sometimes referred to as RO or CRO). The filing of the petition for appointment of the RO triggers an automatic stay.[4] This process is dealt with in greater detail below.

4.2.10 Secured creditors

A creditor with security over an asset of a company is entitled to enforce its security notwithstanding the fact that a restructuring officer, provisional liquidator or official liquidator

[4] Companies Act, s 91G.

may have been appointed. The secured creditor may enforce without the leave of the Grand Court and without any reference to the company's restructuring officer[5] or liquidator.[6]

A secured creditor whose debt is more than the value of their security may prove in any liquidation for the unsecured balance. In such circumstances, the proof of debt submitted by the secured creditor must state particulars of the security and the value which they place on the security.[7]

For more on this topic, see paragraph 5 below.

4.2.11 Unsecured creditors

An unsecured creditor has the right to file a winding-up petition in respect of a debtor company.

4.2.12 No insolvency regulator

The Cayman Islands does not have an insolvency regulator.

It should be noted, however, that the Cayman Islands Monetary Authority (CIMA) has powers to appoint "Controllers" over any of the entities it is charged with licensing and supervising (such as banks, trust companies, regulated mutual funds). "Controllers", as their name suggests, are appointed by CIMA to take control (at board level) of an entity that appears to be in breach of its regulatory obligations. The controller will report back to CIMA. CIMA then has the power to apply for the winding-up or reorganisation of the regulated entity.[8]

Self-Assessment Exercise 1

Question 1

On which legal system is the Cayman Islands system loosely based?

Question 2

To which court or courts may a litigant appeal following receipt of an adverse decision at first instance?

Question 3

Which law or laws govern insolvency in the Cayman Islands?

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5 *Idem*, s 91H.
6 *Idem*, s142.
7 Companies Winding up Rules (CWR) O.17, r.1.
8 Notices of CIMA enforcement decisions can be found here: https://www.cima.ky/enforcement-notices.

For commentary and feedback on self-assessment exercise 1, please see APPENDIX A

5. SECURITY

In the Cayman Islands, security may be taken over immovable and / or movable assets.

As already mentioned above, notwithstanding that a restructuring officer or liquidator has been appointed, a creditor that has security (over the whole or part of the assets of a company) is entitled to enforce its security without the leave of the Court and without reference to the liquidator. There is no stay on enforcement by secured creditors like in Chapter 11 proceedings in the USA.

5.1 Immovable property

The following are the most common forms of security rights which may be granted over immovable property:

5.1.1 Mortgage

Security over real property (freehold or leasehold) is usually granted by mortgage. There are two different types of mortgage:

5.1.1.1 Legal mortgage

This is where the lender (mortgagee) holds legal title to the property as security for a debt. The debtor / borrower (mortgagor) retains possession of the property and recovers legal ownership once the secured debt is discharged. If the debtor defaults, the secured creditor will be permitted to take possession and exercise its power of sale with respect to the property, or it may appoint a receiver to realise the real property.

Legal mortgages over certain types of property must be created by deed and validly executed. The Register of Lands must be updated. Registration puts third parties on notice and ensures the mortgagee has priority over them.

5.1.1.2 Equitable mortgage

This is where the debtor / borrower (mortgagor) transfers the beneficial or equitable interest in the property to the lender (mortgagee) while retaining possession and legal interest in the property.

Generally, the mortgagee does not have a right to take possession of the collateral; however, the mortgage agreement may contain a power of attorney in favour of the secured creditor permitting it to execute a transfer of land document to transfer the property into its name upon default.

In the absence of a power of attorney provision, the secured creditor will need to apply to court for specific performance. The court may then convert the equitable mortgage into a legal mortgage conferring associated rights and powers.

An equitable mortgage does not take priority over a third party who has no notice of the security interest and who acquires legal title to the property in good faith and for value (a *bona fide* purchaser). It is therefore a weaker form of security compared to a legal mortgage.

Equitable mortgages can be in writing and are usually created by deed.

5.1.2 Fixed charge

A fixed charge gives the creditor the right to take possession of the charged property (and sell it) if the borrower defaults.[9]

Once the property is sold, the creditor may apply the proceeds of sale to the debt owed to it.

The charged property is not deemed to be an asset of the debtor in the event of its insolvency.

The debtor cannot sell the charged property without the creditor's consent.

Fixed charges must be in writing and are typically created by deed.

5.2 Movable property

The most common forms of security taken over movable property are:

5.2.1 Mortgage

Mortgages are commonly used as security over ships and aircraft. Such mortgages need to be registered on the respective vessel or aircraft register.

Mortgages over shares are also common in the Cayman Islands. This is achieved by an agreement to create such a mortgage, the entry of the secured creditor's name into the register of members as the holder of the shares and the deposit of the relevant share certificate, if any, with the secured creditor.

5.2.2 Fixed charge

See the explanation of fixed charges over immovable property above.

[9] See, eg, *Scotiabank (Cayman Islands) Limited v Treasure Island Resort (Cayman) Limited* [2004-2005 CILR 423].

5.2.3 Floating charge

A floating charge is typically taken over a class of assets that change from day to day. Often, a secured creditor will take a fixed charge over specific assets together with a floating charge over all other assets not covered by the fixed charge. Both types of charge are created by contract (or by operation of law).

The floating charge does not attach to a particular asset, but hovers over one or more assets. Such a charge is usually taken over a debtor's inventory or its entire business.

Unlike the fixed charge, the debtor can deal with its charged assets, subject to the terms of the charge, without the creditor's consent.

Upon the occurrence of a specified event of default, the floating charge "crystallises" and converts into a fixed charge which then attaches to the debtor's specific assets at that point in time.

If for any reason the floating charge has not crystallised at the commencement of the liquidation of the debtor, the assets continue to be assets of the debtor for the purposes of the liquidation. The chargee's claim, however, will have priority over the claims of any unsecured creditors.

5.2.4 Pledge (also known as bailment)

A pledge is a legal form of security which is created by contract and perfected through delivery of possession of the asset to the secured creditor. Such delivery can be actual or constructive.

An asset may be pledged as security for a loan. In the event of a default on the loan, the lender has the right to take possession of the pledged asset and sell it.

The requirement for delivery means that this is only used for movable assets.

5.2.5 Lien

This is similar to a pledge; however, a lien gives a creditor the right to keep possession of an asset that belongs to the debtor until the debt is paid. The creditor is only entitled to retain the asset in its possession; it is not entitled to sell the asset if the debtor defaults. Liens are created by contract, common law and / or statute.

5.3 Registering security

The Cayman Islands does have ownership registers for real estate,[10] ships,[11] aircraft,[12] motor vehicles and intellectual property.[13] These registers are centrally maintained. Mortgages and

[10] Registered Land Law.
[11] Maritime Authority Law.
[12] Civil Aviation Authority Law and Mortgaging of Aircraft Regulations.
[13] https://www.ciipo.ky/laws/.

charges can be registered therein. Registration means that a third-party purchaser of the charged asset will be deemed to have notice of any such interest and will therefore acquire the asset subject to the secured creditor's interest. Registration also gives the secured creditor priority over non-registered creditors.

There is, however, no public security registration regime in the Cayman Islands for other types of assets. A creditor must therefore take adequate steps to investigate (in advance) whether a particular asset is already encumbered and also to ensure that it has sufficient control over an asset to prevent a third party from purchasing it. For example, any lender would be well advised to review the debtor company's register of mortgages (see below).

Section 54 of the Companies Act requires that security interests be entered in the register of mortgages and charges of the debtor company. The register must be maintained by the company at its registered office in the Cayman Islands. In practice, however, companies do not always comply with this obligation. It is important to note that any failure of a company to update the register of mortgages and charges does not, in and of itself, invalidate any security interests that are not recorded.

Registering a security interest in the company's register of mortgages and charges does not create priority. However, the register is open for inspection by any member of the company or creditor and therefore registration does put third parties on notice of the existence of a security recorded therein. A lender would therefore be well advised to insist that the register is updated when it lends money to the company.

Under Cayman Islands conflict of laws rules, the relevant law governing the priority and perfection of security interests will be determined by the location of the asset.

Self-Assessment Exercise 2

Question 1

Name the common forms of security in the Cayman Islands for immovable property.

Question 2

Name the common forms of security in the Cayman Islands for movable property.

Question 3

How can a lender ensure that other people have notice of its secured position?

For commentary and feedback on self-assessment exercise 2, please see APPENDIX A

6. INSOLVENCY SYSTEM

6.1 General

The Cayman Islands has a fragmented insolvency system in the sense that different primary and secondary legislation must be consulted depending on whether one is dealing with a personal or a corporate debtor.

Personal Insolvency is governed by:

- The Bankruptcy Act (Cap 7) (1997 Revision); and
- The Grand Court (Bankruptcy) Rules (2021 Revision).

Corporate Insolvency in the Cayman Islands is regulated by:

- The Companies Act (2022 Revision) (as amended);
- The Companies Winding Up Rules, 2018 (as amended);
- The Insolvency Practitioners' Regulations 2018; and
- The Foreign Bankruptcy Proceedings (International Cooperation) Rules 2018.

The Cayman Islands is regarded as a creditor-friendly jurisdiction. Creditors are not treated differently based on whether they are based in the Cayman Islands or elsewhere. The Cayman Islands has taken a conscious decision to remain creditor-friendly to attract international business.

6.2 Personal / consumer bankruptcy

Personal bankruptcy is rare in the Cayman Islands, which probably accounts for the failure of the legislature to update the antiquated language and unrealistically low monetary figures in the legislation.[14]

6.2.1 Legislation

As stated above, individual insolvency is governed by:

- The Bankruptcy Act (1997 Revision); and
- The Grand Court (Bankruptcy) Rules 2021.

[14] For a recent example, see *In the Matter of Pelletier (a debtor)* [2020 (1) CILR 570].

6.2.2 Court

The Grand Court is the Chief Court of Bankruptcy, which hears all applications for personal bankruptcy.[15]

6.2.3 Who qualifies as a "debtor"

Section 2 of the Bankruptcy Act defines a "debtor" to include any person who, at the time when any act of bankruptcy was done or suffered by him, –

- was personally present in the Islands;
- ordinarily resided in, or had a place of residence in, the Islands;
- was carrying on business in the Islands, personally or by means of an agent or manager; or
- was a member of a firm or partnership which carried on business in the Islands.

6.2.4 Commencement of proceedings

Proceedings may be commenced by filing a petition with the Grand Court.[16] A debtor may present a bankruptcy petition against himself. Alternatively, a single creditor, or two or more creditors, may present a bankruptcy petition to the Court against a debtor, provided the aggregate amounts of debt owing are not less than KYD 40.

6.2.4.1 Grounds for petition (Acts of Bankruptcy)

A debtor may present a bankruptcy petition against himself without alleging any grounds.[17] However, the petition must be accompanied by a statement setting out details of the debtor's financial affairs.[18]

Creditors applying for the bankruptcy of a debtor must allege at least one "act of bankruptcy" from the following list:[19]

(a) that the debtor has, in the Islands or elsewhere, made a conveyance or assignment of their property to a trustee or trustees for the benefit of their creditors;

(b) that the debtor has, in the Islands or elsewhere, made a fraudulent conveyance, gift, delivery or transfer of their property or any part thereof;

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15 Bankruptcy Act, s 3(1).
16 *Idem*, s 4.
17 *Idem*, s 15; see, eg, *Northern Mariana Islands Government v Millard and Millard* [2014 (1) CILR 342.
18 *Idem*, s 17.
19 *Idem*, s 14.

(c) that the debtor has, with intent to defeat or delay their creditors, departed out of the Islands, departed from their dwelling-house, otherwise absented themself, begun to keep house or begun to sell their stock-in-trade at an under-value;

(d) that the debtor has, by any act, declared themself unable to meet their engagements;

(e) that the debtor has presented a bankruptcy petition against themself;

(f) that execution issued in the Islands against the debtor on any legal process for the obtaining of payment of any sum of money has been levied by seizure and sale of their goods, or enforced by delivery of their goods;

(g) that the creditor has served on the debtor a summons in an action in the Grand Court wherein the creditor claims payment of a liquidated sum of not less than KYD 40;

(h) that the creditor presenting the petition has obtained final judgment against the debtor for not less than KYD 40 and has served on the debtor in the Islands a bankruptcy notice in writing and the debtor has not, within seven days after the service of notice, paid such amount;

(i) that the debtor has not paid an obligation of not less than KYD 40 upon a negotiable security within 14 days;

(j) that the debtor has, in the Islands or elsewhere, made any conveyance or transfer of their property which would be void as a fraudulent preference if they were adjudged bankrupt;

(k) that the debtor has, in the Gazette and in a newspaper circulated in the Islands, given notice of their intention to convey, assign or transfer their stock-in-trade, debts or things in action relating to their business to any other person; and that the creditor, having a demand against the debtor of not less than KYD 40, has served on the debtor in the Islands a bankruptcy notice in writing, and that the debtor has not, within seven days after the service of such notice, paid such amount.

(l) that the debtor has paid money to or given or delivered any satisfaction or security for the debt of a petitioning creditor, or any part thereof, after such creditor has presented a bankruptcy petition against the debtor.

In addition to establishing one of the above acts of bankruptcy:

- the alleged act of bankruptcy must have occurred within six months before the presentation of the petition; and

- the debt of the petitioning creditor must be a liquidated sum due, or growing due at law or in equity, and must not be a secured debt.

6.2.4.2 Provisional order

After the presentation of a petition, if the court is satisfied of the evidence of the creditor's debt, the court will make a provisional order that the affairs of the debtor shall be wound up and their property administered under the Act.[20]

6.2.4.3 Service and notice to show cause

The provisional order is served on the debtor, together with a notice that within a specified number of days the debtor may show cause why the provisional order should be revoked.[21]

6.2.4.4 Revocation of provisional order

If the debtor, within the time appointed, shows to the satisfaction of the Court that either the proof of the petitioning creditors debt, or of the act of bankruptcy, is insufficient, the Court must revoke the provisional order and, unless it sees good cause to the contrary, will order costs to be paid to the debtor.[22]

6.2.4.5 Statement of affairs

If the debtor does not show cause why the provisional order must be revoked, an order is served on the debtor requiring them to file, within the specified number of days, a statement of their affairs.[23]

6.2.4.6 Absolute order

If the debtor fails to comply with the order to file their statement of affairs, or to show a sufficient excuse for not having complied with it, the Court may, on the application of any creditor, make an absolute order for bankruptcy against the debtor.[24]

6.2.5 Stay

All proceedings to recover debts are stayed upon the making of a provisional or absolute order[25] unless leave of the Court is obtained.[26]

The effect of the provisional order is retroactive (to the date of the proven "act of bankruptcy").[27]

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[20] *Idem*, s 29; see, eg, *In the Matter of Joe Otu, Margaret Mendes, Josephine Otu and Fernando Mendes* [2011 (1) CILR 26].
[21] *Idem*, s 30.
[22] *Idem*, s 31.
[23] *Idem*, s 32.
[24] *Idem*, s 33.
[25] *Idem*, s 34(1).
[26] *Idem*, s 35(2).
[27] *Idem*, s 35.

Secured creditors: This stay does not affect the power of any secured creditor to realise or otherwise deal with their security in the same manner as they could have done prior to the making of the provisional or absolute order.[28] Secured creditors may appoint receivers to enforce security rights (see below).

6.2.6 Property vests in Trustee in Bankruptcy

Upon a provisional or absolute order being made, the property of the debtor immediately passes to, and vests in, the Trustee in Bankruptcy (Trustee).[29]

The Trustee is attached to the Court. It administers the estates of debtors in bankruptcy subject to the Bankruptcy Act.

6.2.7 Powers and duties of Trustee

Until the provisional order is made absolute, it is the duty of the Trustee to preserve the property such that it may be returned to the debtor in the event the provisional order is revoked.[30]

The Trustee may carry on the trade of the debtor so far as may be necessary or expedient for the beneficial winding up or sale of the business.[31]

The Trustee may bring or defend any legal proceedings relating to the property of the debtor.[32]

The Trustee must receive and adjudicate the proof of debts.[33] The way proof of debts must be filed is set out in the Grand Court (Bankruptcy) Rules 2021.

Once an absolute order has been made, the Trustee must proceed to administer the debtor's estate for the benefit of the creditors.[34]

6.2.8 Allowances to debtor for support

The Trustee may, from time to time, make such allowances to the debtor as the Trustee thinks just (out of the debtor's property) for the support of the debtor and their family, or in consideration of the debtor's services if the debtor is engaged in the winding up of their own estate.[35]

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[28] *Idem*, s 34(3).
[29] *Idem*, s 37.
[30] *Idem*, s 38.
[31] *Idem*, s 79.
[32] *Idem*, s 80.
[33] *Idem*, s 87.
[34] *Idem*, s 65.
[35] *Idem*, s 137.

6.2.9 Onerous and unprofitable property

The Trustee may disclaim onerous and unprofitable property in certain prescribed circumstances. These circumstances, and the effects of such disclaimer, are set out in section 105 of the Bankruptcy Act.

6.2.10 Duty to aid Trustee

The debtor has a duty to aid the Trustee in the realisation of their property and the distribution of the property among their creditors.[36] Failure to do so amounts to contempt.[37]

6.2.11 Meetings of creditors

The Court must, as soon as practicable after the provisional order, summon a general meeting of the creditors of the debtor. Such a meeting will not take place if an absolute order has been made.[38]

Various rules, which are beyond the scope of this module, govern such meetings. These rules include:

- A person is not entitled to vote at such a meeting unless they have, in the prescribed manner, proved a debt that is due to them; and
- A secured creditor will only be deemed to be a creditor for the purposes of voting in respect of any balance due to the debtor.

At the meeting the creditors may, by the votes of a majority in value of the creditors present, personally or by proxy,[39] resolve that:

- the petition be stayed, the affairs of the debtor wound up and their property administered under a "deed of arrangement"; or
- that an adjudication of bankruptcy be made.

6.2.12 Deed of arrangement

A deed of arrangement may be entered into between a debtor and their creditors,[40] provided the deed is assented to by a majority in number (more than 50%) representing 75% in value of the creditors of the debtor who have proved their debt.

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[36] *Idem*, s 39.
[37] *Idem*, s 40.
[38] *Idem*, s 41.
[39] *Idem*, s 44.
[40] *Idem*, s 48.

The deed of arrangement must be taken into consideration by the court but, before the deed is considered by the court, the debtor must submit themself to the public examination of the Court and the Trustee must make a report to the Court under section 67 of the Bankruptcy Act.[41]

The Court will confirm the deed if it appears to be in the interest of the creditors generally that it should be so confirmed. Only then will the deed become binding on all creditors and the debtor.

If a deed is so approved, the terms of the deed will provide for the date and circumstances in which the debtor will ultimately be discharged.[42]

6.2.13 Absolute orders

When an absolute order for bankruptcy has been made against a debtor, a public examination of the affairs of the debtor must take place. The debtor must attend and submit to examination.[43]

If it appears to the Court that the debtor has failed to keep proper books of account or that they have incurred debt by breach of trust or without having had any reasonable expectation of being able to repay such debt, the Court has the discretion to imprison them.[44]

6.2.14 Trustees report

It is the duty of the Trustee, as soon as possible after the close of the public examination of the debtor, to make a report as to the state of the debtor's affairs and as to the conduct of the debtor before and during the bankruptcy.[45]

In particular, the Trustee is required to note in its report any matters which might constitute offences under the Bankruptcy Act and / or which would justify the Court refusing, suspending or qualifying an order for the debtor's discharge.

6.2.15 Divisible property

When a provisional order has been made against a debtor, their property becomes divisible between their creditors in proportion to the debts owed.

The property of the debtor divisible amongst their creditors and vesting in the Trustee will be comprised of:[46]

41 *Idem*, s 50.
42 *Idem*, s 55.
43 *Idem*, s 62.
44 *Idem*, s 64.
45 *Idem*, s 67.
46 *Idem*, s 100.

(a) all such property as may belong to, or be vested in, the debtor at the commencement of the bankruptcy or which may be acquired by, or devolve on, them at any time previous to their discharge;

(b) the capacity to exercise, and to take proceedings for exercising, all such powers in, or over, or in respect of, property as might have been exercised by the debtor;

(c) all goods and chattels being at the commencement of the bankruptcy in the possession of the debtor.

6.2.16 Non-divisible property

The following property of the debtor is not available to satisfy claims:[47]

(a) property held by the debtor on trust for any other person; or

(b) the tools, if any, of their trade, the clothes and bedding of the debtor, their spouse and children to a value not exceeding KYD 60 in the whole.

In addition, marital property may be exempt depending on the date and circumstances of its settlement.

6.2.17 Secured creditors

A secured creditor may on giving security prove for their whole debt, or they may prove for any balance due to them after realising or giving credit for the value of their security.

6.2.18 Priority creditors

The following debts are paid in priority to all other debts:[48]

(a) all public taxes imposed by law due from the debtor at the date of the provisional order not exceeding in the whole one year's taxes;

(b) all wages or salary of any clerk or servant in respect of services rendered to the debtor for four months preceding the date of the provisional order, not exceeding KYD 100; and

(c) all wages of any labourer or workman in respect of services rendered to the debtor for four months preceding the date of the provisional order.

These debts rank equally and must be paid in full unless the property of the bankrupt is insufficient to meet them.

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47 *Idem*, s 100(i-ii).
48 *Idem*, s 135.

6.2.19 Preferences and void payments

Such payments are governed by Part XVII of the Bankruptcy Act.

Any conveyance, transfer, charge or payment made by a debtor in favour of any creditor, with a view to giving such creditor a preference over the other creditors, must, if a provisional order takes effect within six months, be deemed fraudulent and void as against the Trustee.

Any disposition, made by any trader unable to pay their debts, of their stock-in-trade or things in action relating to their business, otherwise than in the ordinary course of business, shall, if a provisional order or an absolute order takes effect within six months, be deemed fraudulent and void as against the Trustee, except in the following circumstances:

(a) if the dispositions were made and executed with the assent of 75% in number and value of the creditors;

(b) the same were made and executed after not less than 21 days' notice in the Gazette and in a newspaper circulated in the Islands of the intention of the trader to make such disposition.

6.2.20 Bailiff[49]

When the goods of a debtor have been taken in execution in respect of a judgment and sold, the bailiff must, if it has notice of a petition filed against the debtor, hold the balance of the proceeds of the sale, after deducting expenses, upon trust to pay the same to the Trustee.

When the goods of a debtor have been taken in execution in respect of a judgment and not sold before the bailiff or officer executing the process receives notice of the appointment of a receiver or Trustee under a bankruptcy petition, the bailiff after receipt of the notice, must deliver up such goods to the receiver or Trustee.

6.2.21 Creditor that has executed on property

A creditor who has levied execution on the property of a debtor, or has made an attachment thereof, is not entitled to retain the benefit of such execution or attachment unless and except insofar as they have, before the filing of a petition against or by such debtor, enforced such execution by sale of the property seized, or enforced such attachment by actual possession of the moneys attached or, as the case may be, by sale of the property attached.[50]

6.2.22 Landlord

A landlord to whom any rent is due from the debtor may, at any time, either before or after the commencement of the bankruptcy, distrain upon the goods or effects of the debtor for the rent due to them.[51]

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[49] *Idem*, s 114-115.
[50] *Idem*, s 116.
[51] *Idem*, s 117.

If such distress for rent is levied after the commencement of the bankruptcy, it will be available only for one year's rent accrued due prior to the date of the provisional order.

After notice received by the person making the distress of the appointment of the Trustee or receiver, no sale may be made of the goods distrained, unless the Court otherwise orders, except by the Trustee or receiver.

6.2.23 Netting-off

Where there have been mutual credits, mutual debts, or other mutual dealings, between the debtor and any person having a debt provable under the bankruptcy petition, netting-off is allowed.[52]

6.2.24 Debtor's discharge

The debtor may, at any time after the filing of such report, apply for an order of discharge.[53]

The Trustee or any creditor may oppose the discharge and may show cause why it should be refused, postponed, or made subject to conditions.[54]

The Court may grant the discharge unconditionally or conditionally or it may suspend or refuse the discharge.[55]

The discharge, if made, releases the debtor from their debts (subject to any conditions set out by the Court and subject to the *caveat* that it shall not release a bankrupt from any liability incurred by means of fraud).[56]

Self-Assessment Exercise 3

Question 1

Which law governs personal bankruptcy in the Cayman Islands?

Question 2

Which debtors may be subject to the jurisdiction of the bankruptcy court?

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52 *Idem*, s 127.
53 *Idem*, s 68(1); see, eg, *In the Matter of Foster (A Debtor)* [2016 (2) CILR 69].
54 *Idem*, s 68(2).
55 *Idem*, ss 68 and 70.
56 *Idem*, s 71.

Question 3

Name five acts or defaults which can be alleged by a petitioner as the grounds of a personal bankruptcy petition?

Question 4

Is all the debtor's property available to creditors?

For commentary and feedback on self-assessment exercise 3, please see APPENDIX A

6.3 Corporate liquidation

6.3.1 Introduction

In addition to personal bankruptcy matters, the Grand Court of the Cayman Islands also has jurisdiction over corporate liquidations and restructurings.

The Grand Court has jurisdiction[57] to make orders in respect of companies which are either:

(a) incorporated in the Cayman Islands;

(b) incorporated elsewhere but subsequently registered in the Cayman Islands; or

(c) in respect of a foreign company which –

(i) has property located in the Islands;

(ii) is carrying on business in the Islands;

(iii) is the general partner of a limited partnership; or

(iv) is registered under Part IX (a so-called "overseas company").

6.3.2 Types of corporate liquidation

The Cayman Islands Companies Act (Part V) provides for three types of corporate liquidations:

(a) voluntary liquidations;

[57] Companies Act, s 91.

(b) provisional liquidations; and

(c) official liquidations.

6.3.2.1 Voluntary liquidation

Introduction

A company may be wound up voluntarily.[58]

Voluntary liquidation is governed primarily by sections 116-130 of the Companies Act. In a voluntary liquidation, the affairs of the company are wound up and creditors are paid. Any excess assets after payment of creditors are distributed to the shareholders.

Generally, in a voluntary liquidation, the company must cease trading except where it is necessary and beneficial to the liquidation.[59]

Circumstances that may initiate a voluntary liquidation

A company may be wound up voluntarily[60] if:

(a) the company by special resolution resolves that it be wound up voluntarily;

(b) if the company by ordinary resolution resolves that it be wound up voluntarily as a result of the inability to pay its debts;

(c) where the duration of the company as fixed by its memorandum or articles of association has expired; or

(d) if an event occurs which the memorandum or articles provide is to trigger the company's winding-up.

Commencement

A voluntary liquidation is deemed to commence at the time of the passing of the resolution for winding-up, or on the expiry of the period or the occurrence of the event specified in the company's memorandum or articles.[61]

[58] *Idem*, s 90(b).
[59] *Idem*, s 118.
[60] *Idem*, s 116.
[61] *Idem*, s 117.

Role of voluntary liquidator

There are no professional qualification requirements for the role of a voluntary liquidator[62] and no authorisation is required from the Grand Court for a voluntary liquidator to exercise their powers.

As such, directors may be (and often are) appointed as voluntary liquidators. In the event a voluntary liquidator who is not a director is appointed, the directors are displaced by the voluntary liquidator.

Applications to Grand Court

A voluntary liquidator may apply to the Grand Court to determine any issue that arises during the winding-up process, or for an order that the liquidation be continued under the Court's supervision.[63]

Declaration of solvency

A company may only be wound up voluntarily if it is solvent.[64] A voluntary liquidator is required to apply to the Grand Court for an order that the liquidation be carried out under the Grand Court's supervision unless the directors sign a declaration that the company will be able to meet its debts in full within a period not longer than 12 months from the commencement of the voluntary liquidation.[65] This is known as a "declaration of solvency". The declaration must be signed within 28 days of the initiation of the voluntary liquidation failing which there is a presumption that it is insolvent.

Application for court supervision

Even after a declaration of solvency has been made by the directors, the voluntary liquidator, any creditor, or shareholder can apply to bring the liquidation under the Grand Court's supervision on the following grounds:[66]

(a) the company is, or is likely to become, insolvent; or

(b) court supervision will facilitate a more effective, economic, or expeditious liquidation of the company in the interests of the shareholders and creditors.[67]

If a voluntary liquidation is brought under the supervision of the Grand Court, it continues as an official liquidation (see below). Indeed, the effect of the supervision order is to place the

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62 *Idem*, s 120.
63 *Idem*, s 129. Winding-up subject to the supervision of the Court is governed by ss 131-133.
64 *Idem*, s 116.
65 *Idem*, s 124.
66 *Idem*, s 131.
67 See, eg, see *In the Matter of Asia Private Credit Fund Limited (in voluntary liquidation)* [2020 (1) CILR 134].

company into official liquidation with retroactive effect from the commencement of its voluntary liquidation.

No moratorium

There is no protection from the company's creditors during a voluntary liquidation. Debts must be paid as they fall due. If they are not paid, secured creditors can enforce their security and unsecured creditors can initiate winding-up proceedings against the company.

No set-off or net-off

The voluntary liquidator is required to pay claims in full. There is no statutory set-off or netting-off during a voluntary liquidation.

No adjudication process

There is also no process for adjudicating creditors' actual or contingent claims. Any disputes need to be determined by whichever court has jurisdiction over the claim.

No power to disclaim onerous contracts

The voluntary liquidator has no statutory power to disclaim onerous contracts. The normal rules governing breach of contract therefore apply.

Liquidator reports

A voluntary liquidator is required and expected to provide reports and accounts to the company's shareholders. Reporting should also be provided on request to creditors who have not been paid in full.

Reporting is done in connection with each annual general meeting and the final meeting in the voluntary liquidation, or whenever the voluntary liquidator thinks appropriate.

Rights to information

Aside from the above liquidator's reports, shareholders and creditors have no other statutory rights to information during a voluntary liquidation.

Timeframe

Voluntary liquidations are generally quicker than official liquidations; however, the duration of a voluntary liquidation is largely determined by the complexity of the winding-up process.

The law contemplates that all creditors in a voluntary liquidation will be paid in full within 12 months. As stated above, the law imposes an obligation on the voluntary liquidator to apply to

bring the liquidation under the Grand Court's supervision unless all the directors swear a statutory declaration of their belief that the company will be able to comply with this timeline.

General meeting

After the business of the company is wound up, the liquidator must call a general meeting of the company to present their account of the voluntary liquidation. They must thereafter file a return with the Registrar of Companies.[68]

Dissolution

The company is deemed to have been dissolved three months after the return's registration date.[69]

6.3.2.2 Provisional Liquidation

Entities that are covered

As with other kinds of liquidation (voluntary and official), provisional liquidation (PL) is available to any company liable to be wound up under the Companies Act.[70]

Uses

In the absence of a formal, statutory restructuring regime, PL was often used in the past as a device to secure a moratorium against creditor's claims whilst a compromise or arrangement with the company's shareholders or creditors was negotiated.

Since changes to the Companies Act came into force on 30 August 2022 (see the section dealing with 'restructuring officers' below), provisional liquidation will no longer be used for this purpose. It will, however, remain available as an important tool to preserve and protect a company's assets pending the appointment of official liquidators.

Standing to apply

Applications to appoint provisional liquidators may be made by the company itself, by creditors, by shareholders or by the Cayman Islands Monetary Authority (CIMA).[71]

Grounds for application

Per section 104 (2) of the Companies Act, creditors, shareholders, or CIMA may make an application (which may be made *ex parte*) on the grounds that:

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[68] Companies Act, s 127.
[69] *Idem*, s 151.
[70] *Idem*, s 91.
[71] *Idem*, s 104(2).

(a) There is a *prima facie* case for a making a winding up order;[72] and

(b) The appointment of a provisional liquidator is necessary to:

(i) preserve and protect the company's assets;

(ii) prevent the oppression of minority shareholders; or

(iii) prevent mismanagement of the company's affairs by the directors.

Per section 104(3) of the Companies Act, the company itself may make an application for provisional liquidation.

Appointment and powers of the provisional liquidators

The provisional liquidator (or, where there is more than one, the joint provisional liquidators or JPLs) will be appointed by the Court. Since the application for provisional liquidation is often made *ex parte*, the JPL will normally be nominated by the applicant who files the petition.

The powers and duties (including reporting obligations) of the provisional liquidators are given to them in the court order that appoints them. The applicant should be prepared to justify to the Court the reason for each power sought in the draft order of appointment.

Management participation

Each order is tailored to the specific needs of the case and the extent of the powers granted by the court to the PL depends upon the reason for the PLs' appointment. For example, if the PL is appointed to prevent mismanagement, it is likely the entirety of the board's powers may be removed from them and vested in the PL. In other scenarios, the board may retain most of its powers and the PL's role may be more limited.

Historically, when PL's were appointed largely to secure a moratorium from creditor claims, the PLs powers would often be quite limited. This was commonly referred to as "light touch" provisional liquidation, where existing management was allowed to continue in control of the company but subject to the supervision of the provisional liquidator and the Grand Court. As discussed elsewhere in this text, this technique to secure a restructuring has now been superseded by the statutory 'restructuring officer'.

Provisional liquidation committee

The Grand Court may direct that an *ad hoc* provisional liquidation committee be established. The committee's mandate is normally to assist and act as a sounding board for the provisional liquidators and to monitor the PL's fees. It should be noted, however, that such a committee is

[72] See Official Liquidation below.

not a creature of statute and will usually not have the same powers as the LC in an official liquidation.

Statutory moratorium

Pursuant to Section 97 of the Companies Act, once a provisional liquidator is appointed, no action or proceeding may be commenced or continued against the company without the leave of the Grand Court. Traditionally, this has been a key feature of the provisional liquidation process.[73]

The stay does not, however, prevent secured creditors from enforcing their security.

Adjudication of claims

There is no statutory mechanism for the adjudication of creditors' claims during a provisional liquidation. Claims will be submitted and adjudicated as part of any official liquidation that may ensue.

Onerous contracts

Provisional liquidators have no statutory power to disclaim onerous contracts. Failure to comply with any such contracts will therefore have the usual consequences for breach of contract.

Essential contracts / supply of utilities

If a request is made by a liquidator or provisional liquidator for the continued provision (after the date of the appointment of the provisional liquidator or date on which the winding up order was made) of electricity, water or telecommunications, the relevant utility supplier may make it a condition of the provision of such supply that the liquidator personally guarantees the payment of any charges in respect of that supply.

The supplier may not, however, make it a condition of the supply that any outstanding charges (which pre-date the appointment of the liquidator / winding up order) are paid.[74]

Timeframe

The time taken to complete a provisional liquidation depends on several factors, including its purpose.

If the purpose of the provisional liquidation is to preserve the assets until the hearing of a winding-up petition, the duration is typically short (four to eight weeks of the petition being filed).

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[73] For a case in which leave was sought to lift the stay, see *In the Matter of the Wimbledon Fund SPC (in official liquidation)* [2019 (1) CILR note 1].

[74] Companies Act, s 148.

Conclusion of a provisional liquidation

An application for provisional liquidation may be concluded in the following circumstances:

- A winding-up order is made at the first hearing (that is, the company enters official liquidation meaning the company will be dissolved at the end of a liquidation process);
- A winding-up petition is dismissed;
- The provisional liquidator, the company, a creditor, or a shareholder applies for an early termination of the provisional liquidators' appointment and such application is granted; or
- An appeal against the provisional liquidator's appointment succeeds.

6.3.2.3 Official liquidation

The purpose of an official liquidation is to wind up the company and distribute its assets to its creditors and shareholders.

The court is central to the process. It decides to appoint official liquidators, considers whether to approve certain actions of the liquidators (sale of assets, leave to commence litigation, compromise of claims) and sanctions payment of the liquidators' remuneration and expenses.

Entities that may be officially liquidated

As with voluntary liquidations and provisional liquidations, official liquidations are available to:[75]

(a) companies incorporated and registered under the Companies Act;

(b) bodies incorporated elsewhere but registered in the Cayman Islands; and

(c) foreign companies which:

(i) carry on business or have property located in the Cayman Islands;

(ii) are the general partner of a limited partnership registered in the Cayman Islands; or

(iii) are registered under Part IX of the Companies Act (so-called "overseas companies").

Functions of the official liquidator(s)

The functions of official liquidators are:[76]

[75] *Idem*, s 91.
[76] *Idem*, s 110.

(a) to collect, realise and distribute the assets of the company to its creditors and, if there is a surplus, to the persons entitled to it; and

(b) to report to the company's creditors and contributories upon the affairs of the company and the manner in which it has been wound up.

Standing to present a petition

Section 94 of the Companies Act states that an application to the Court for the winding-up of a company must be by petition presented either by:

(a) the company;

(b) any creditor;

(c) any shareholder of the company; or

(d) the Cayman Islands Monetary Authority (which is the financial services regulator).[77]

The right to present a petition is, however, subject to any contractually binding non-petition clauses.

Until earlier this year, a company could only file a winding up petition if the directors had obtained a shareholder resolution authorising them to do so, or they had been duly authorised to do so in the company's articles of association.[78] Since the commencement of the Companies (Amendment) Act 2021, this rule **does not apply to companies incorporated on or after 30 August 2022**. For these newly incorporated companies, the default position is that the directors have statutory authority to present a winding up petition without the approval of shareholders and / or without express authority being conferred in the articles (thereby reversing the previous position under Cayman Islands law). Companies may, however, elect to expressly modify or remove this statutory right (with the necessary amendments to their governing documents).

Although not necessary for this course, practitioners should also note the procedural guidance (for filing a winding up petition) at PD 4 of 2017.

Grounds upon which an entity may be wound up

A company may be wound up by the Grand Court if any of the following apply:[79]

(a) the company passes a special resolution requiring it to be wound up by the court;

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[77] There have been several high-profile applications by CIMA in recent years concerning regulated entities (banking, securities, insurance) such as *In the matter of OneTradex* and also *In the matter of Caledonian Bank Limited*. A petition is often preceded by the appointment by CIMA of one or more insolvency practitioners to relieve incumbent directors of command.

[78] *Re Emmadart* [1979] 1 All ER 599, followed in *China Shanshui Cement Group Limited* [2015 (2) CILR 225].

[79] Companies Act, s 92.

(b) the company does not commence business within a year of incorporation;

(c) the company suspends its business for a whole year;

(d) the period fixed by the company's articles for the company's duration expires, or an event occurs which, under the articles, triggers the company's winding-up;

(e) the company is unable to pay its debts;

(f) the Grand Court decides that it is "just and equitable" for the company to be wound up; or

(g) the company is carrying on a regulated business in the Cayman Islands and is not duly licensed or registered to do so.

"Unable to pay its debts"

A company is deemed to be unable to pay its debts if:[80]

(a) a creditor to whom the company owes a sum exceeding KYD 100 has served on the company a demand requiring the company to pay the sum due and the company has not been paid for 21 days after the demand;[81]

(b) execution of other process issued on a judgment, decree or order obtained in the Court in favour of any creditor in any proceedings instituted by such creditor against the company, is returned unsatisfied in whole or in part; or

(c) it is proved to the satisfaction of the Court that the company is unable to pay its debts.

Normally it is creditors that bring such applications. As a general rule, shareholders cannot apply on this basis because, if the company is insolvent, such shareholders will no longer have an economic interest in the company.

The onus is on the party petitioning for the winding up of the company to prove that it is insolvent, not on the company to prove its solvency.

The normal test for whether the company can pay its debts[82] is calculated on a cash-flow basis; however, various authorities in recent years have suggested that future cash flow may be considered.[83]

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80 *Idem*, s 93.

81 If the company is disputing the debt claimed on substantial grounds, then the debt cannot form the basis of a winding-up petition.

82 Companies Act, s 93(c).

83 *Re Weavering Macro Fixed Income Fund Ltd (in Liquidation)* [2016 (2) CILR 514].

Cayman Islands law contains no "balance sheet test"; however, the company's general financial position may be relevant to the question of whether it is just and equitable to wind up a company (see below).

"Just and equitable"

Although the categories of "just and equitable" ground are not closed, commonly petitions under this heading rely upon the following bases:

- loss of substratum;
- deadlock;
- mismanagement; and / or
- exclusion from mismanagement.

Such petitions are normally brought by minority shareholders. The court has the power to make alternative orders (such as orders regulating the management going forward, or orders that the minority shareholders be bought out at a fair price) instead of resorting to liquidation of the company and it will often do so.

Moreover, such "just and equitable" applications will rarely be brought in respect of an insolvent company because a petitioning shareholder will need to demonstrate to the court that it has standing to advance a winding up petition (by showing that it has an economic interest in the company). It will only be able to do so where there will be surplus of assets after the company's debts and the expenses of the winding-up have been paid.[84]

Groups of companies

Insolvency proceedings relating to each company in a group must be commenced by a separate petition; however, the Grand Court can (and does) take a pragmatic approach and will sometimes co-ordinate liquidation proceedings in respect of several group companies in the interests of efficiency.

Where appropriate, the Grand Court may order the pooling of assets and liabilities of group companies. This may happen where there are good reasons for piercing the corporate veil,[85] or where the affairs of the separate companies are so interwoven and improperly or inadequately accounted for, that it would be impractical to treat the companies as distinct entities for the

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[84] For those interested in learning more about the "just and equitable" jurisdiction (which relates primarily to solvent companies and is therefore not the focus of this module), there are numerous examples in the reported case law, eg, *Tianrui* [2019 (1) CILR 481; *CTRIP Investment Holding Limited v Ehi Car Services Limited* [2018 (1) CILR 641. For the interaction of arbitration clauses and the "just and equitable jurisdiction", see I*n the Matter of China CVS (Cayman Islands) Holding Corporation* [2019 (1) CILR 266].

[85] See *Prest v Petrodel Resources Ltd*, 2013, UKSC 34.

purpose of effecting the liquidations. It is also utilised where an international group of companies is being wound up.[86]

Alternatively, there may have been a vote from a sufficient majority of creditors in each company by which they agree to a scheme of arrangement that provides for the pooling of assets or a compromise agreement from the liquidators of each company, in relation to cross-claims between group entities.

To achieve such a consolidation, the Grand Court would need to be persuaded to use its discretion with reference to the required majorities being met and there being sufficient benefit to the entities concerned.

In addition, whilst there are no formal provisions for co-operation between liquidators of different companies within a group, there may be circumstances which merit such co-operation. The Grand Court may, therefore, appoint the same liquidators over more than one entity within the group. This will be entirely fact dependent and will involve consideration of the potential benefit to creditors and the risk of any conflict of interest existing or arising.

Liquidators qualifications

Official Liquidators (OLs) must be resident in the Cayman Islands (although foreign practitioners may be appointed jointly with a resident qualified insolvency practitioner)[87] and they must also be qualified Cayman Islands insolvency practitioners (IPs).

It is common for the Court to appoint joint liquidators (for example, one IP from the Cayman Islands together with one from the US, England or Hong Kong), particularly where elements of the work will be undertaken in the US, UK or Asia.

Displacement of board

Once appointed, the OLs displace the company's directors and control the company's affairs, subject to the Grand Court's supervision. The directors may still be required to assist the liquidator and can be ordered to provide information and deliver up assets or records (see below).[88]

Liquidators powers of investigation

Upon taking office, the liquidators are responsible for realising and distributing the assets of the company to the unsecured creditors, but they are also given wide-ranging powers, including the power to require directors, professional service providers or employees to provide

[86] One such example being the BCCI liquidation (*In re BCCI (Overseas) Ltd [2009 CILR 373*]).
[87] Companies Act, s 108.
[88] *Idem*, s 103; for a recent example, see *In the Matter of Asia Private Credit Fund Limited* [2020 (1) CILR 134].

statements of the company's affairs supported by affidavit[89] and, with leave of the Court, to compel certain persons (such as former directors and officers) to submit to oral examination.[90]

More on duties of liquidators

The official liquidator is an officer of the court. He is required to make "himself thoroughly acquainted with the affairs of the company; and to suppress nothing, and to conceal nothing, which has come to his knowledge in the course of his investigation, which is material to ascertain the exact truth in every case before the Court".[91]

He may sell assets with sanction of the court:

> "The primary duty of a liquidator when selling the assets of a company is to take reasonable care to obtain the best price available in the circumstances ... taking into account the nature of the business to be sold, the relevant market, the steps taken to market and to sell the assets and the urgency of the sale."[92]

Liquidation committee

A liquidation committee must be established unless the Grand Court orders otherwise.[93] It is a body representative of the company's stakeholders formed to consult with the liquidators. The liquidation committee acts as a sounding board for the official liquidators and reviews their fees. The committee consists of not less than three and no more than five members (six in circumstances of doubtful solvency) and the eligibility requirements for the nature of the interest of committee members is contingent on the solvency determination made by the official liquidators.[94]

Automatic stay

On the making of a winding-up order, an automatic stay comes into effect which prohibits the commencement or continuation of any action against the company without the leave of the Grand Court.[95]

The automatic stay does not prohibit secured creditors from enforcing their security.[96]

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89 *Idem*, s 101; eg, *In the Matter of Saad Investments* [2010 (2) CILR 422].
90 *Idem*, s 103.
91 *Gooch's Case* 1872, 7 Ch App 207, applied in the local case of *In the Matter of Citrico International Limited* [2004-05 CILR 435].
92 *Trident Microsystems (Far East) Limited* [2012 (1) CILR 424].
93 Companies Winding Up Rules (2018 Revision), Order 9, r (1)(1).
94 *Idem*, Order 9, r (1)(3) – (6).
95 Companies Act, s 97; see, eg, *Wimbledon Fund* referred to above.
96 *Idem*, s 142.

Provable debts

All debts payable on a contingency and all claims against the company, whether present or future, certain or contingent, ascertained or sounding only in damages, are admissible to proof against the company.[97]

The official liquidator must make a just estimate so far as is possible of the value of all such debts or claims.[98]

There are special rules in relation to the admissibility to proof of foreign taxes, fines, and penalties.

Proofs of debt

Creditors must submit a proof of debt for review by the official liquidator. The proof of debt contains details of the amount and interest owed, including the basis for the debt.

The official liquidator can accept, reject, or request further evidence in relation to a claim.

Creditors can appeal the decision taken by the official liquidator in relation to a proof of claim. On appeal the Grand Court will hear the matter *de novo*. There is no express provision in Part III of O.16 of the Companies Winding up Rules for cross-examination or discovery on appeal, but the Court has allowed cross-examination in exceptional cases in the exercise of its inherent jurisdiction.[99]

Trades, assignments and transfers

Creditors can trade or assign their claims without seeking the leave of the Court (although they will need to give notice to the company of any assignment). Shareholders require both the leave of the Court and consent of the official liquidator to transfer their shareholding.[100]

Onerous contracts

Official liquidators have no statutory power to disclaim onerous contracts. The usual rules in relation to breach of contract apply.

Duty to report

Official liquidators have a duty to report to the Grand Court, liquidation committee, creditors and shareholders.

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97 As demonstrated in *In the Matter of Saad Investments Company Limited (in liquidation)* [2019 (2) CILR 828].
98 Companies Act, s 139.
99 *In the Matter of China Branding Group Limited* [2017 (2) CILR Note 8].
100 Companies Act, s 99.

Rights of inspection

Pursuant to section 114 of the Companies Act, at any time after making a winding-up order, the Court may make such orders as it thinks fit for the inspection of the company's documents by creditors and contributories.

The Court may also order the preparation of reports by the official liquidator and the provision of such reports to the company's creditors and contributories.

If, however, the liquidation file contains confidential documents the disclosure of which may be prejudicial to the economic interests of the parties, the official liquidator can apply to the Grand Court for the file / documents to be sealed (so they are not available for inspection).[101]

Distribution of the company's property

The basic rule is that assets of the company must be applied in satisfaction of its liabilities *pari passu*, following which any assets remaining must be distributed amongst the members according to their rights and interests.[102]

This *pari passu* rule is subject to the very significant *caveat* that effect must first be given to the rights of preferred and secured creditors AND subject to any agreement between the company and any creditors that the claims of such creditors shall be subordinated AND any contractual rights of set-off[103] or netting of claims.[104]

Order of priorities

A secured creditor's rights in a liquidation are superior to the rights of all other parties and sit above the order of priorities listed immediately below.[105]

The order of priorities in an official liquidation is as follows:

(a) liquidation expenses (which includes petitioner's costs, the costs of any restructuring officer and OL's fees and expenses[106]);

[101] Companies Winding up Rules, O.24, r.6; *In the Matter of Sphinx Group of Companies* [2017 (1) CILR 176].
[102] *Idem*, s 140(1).
[103] Creditors are able to exercise common law and contractual rights of set-off and netting against a company following the commencement of liquidation. Save where the creditor had notice (at the time the debt fell due for payment) that liquidation proceedings had been initiated, set-off will be automatic absent any contractual arrangement to disapply it. Where set-off applies, an account will be taken of what the company owes to the creditor and *vice versa* (calculated at the commencement of the liquidation) and the balance after the set-off will be paid to the party to whom it is due.
[104] Companies Act, s 140(2).
[105] *Idem*, s 142.
[106] *Idem*, s 109.

(b) preferential debts,[107] comprising:

(i) sums due to employees;

(ii) taxes due to the Cayman Islands government;

(iii) sums due to depositors (if the company is a bank);

(iv) unsecured debts which are not subject to subordination agreements;

(c) amounts due to preferred shareholders;

(d) debts incurred by the company in respect of the redemption or purchase of its own shares;[108] and

(e) any surplus remaining after payment of the above amounts is returned to the shareholders of the company in accordance with its articles or any shareholders' agreement.

"Preferential debts"

Per section 141 of the Companies Act, in the case of an insolvent company the following debts are paid in priority to all other debts:[109]

(a) sums due to employees;

(b) taxes due to the Cayman Islands government;

(c) sums due to depositors (if the company is a bank);

(d) unsecured debts which are not subject to subordination agreements.

These preferential debts rank equally. If available funds are insufficient to satisfy them in full, they abate in equal proportions.

Preferential charge on good distrained

In the event of a landlord (or other person entitled to receive rent) distraining or having distrained on any goods or effects of the company within three months preceding the date of the winding-up order, the debts to which priority is given by section 141 must be a first charge on the goods or effects so distrained on or the proceeds of sale thereof.[110]

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[107] *Idem*, s 141.
[108] *Idem*, s 37.
[109] *Idem*, Sch 2, "Categories of Preferred Debts".
[110] *Idem*, s 143.

Effect of execution or attachment

Subject to certain qualifications, where a creditor has issued execution against the goods or land of a company, or it has attached any debt due to it and the company is subsequently wound up, the creditor is not entitled to retain the benefit of the execution or attachment against the liquidator unless the creditor has completed the execution or attachment before the commencement of the winding up.[111]

Avoidance of property dispositions

Section 99 of the Companies Act states that any dispositions of a company's property made after the deemed commencement of the winding-up will be void if a winding-up order is subsequently made (unless validated by the Grand Court).[112] In this regard, it is important to remember that the commencement date will be deemed to be the date on which the petition was filed rather than the date on which the order is made.

The liquidator is entitled to apply for appropriate relief to require the repayment of the funds or the return of the asset.

The court does have the power to validate post-petition grants of security (retrospectively or prospectively), therefore a company should seek validation orders (for example, in relation to the grant of security in exchange for new money).

The court normally will validate such arrangements if the company is clearly solvent and provided it is satisfied that an "intelligent and honest" director acting reasonably would come to that decision.[113] The court is unlikely to endorse such an arrangement where the company is insolvent, unless it can be shown that the grant of security has corresponding benefit to the company and enhances the value for creditors as a whole.[114]

Where no petition has yet been filed, any such transaction is not caught by section 99 however it may be subject to other claw-back mechanisms set out immediately below.

Voidable preference

According to Section 145 of the Companies Act, any payment or disposal of property to a creditor constitutes a voidable preference if:

- it occurs in the six months before the deemed commencement of the company's liquidation and at a time when it is unable to pay its debts; and

[111] *Idem*, s 144.
[112] This provision is in the same terms as section 127 of the UK's Insolvency Act 1986 therefore decisions of the courts of England and Wales are treated as persuasive authority.
[113] *In the matter of Fortuna Development Corporation [2004-05] CILR 533.*
[114] See, by way of illustration, *Tianrui (International) Holding Company Limited* [2020 (1) CILR 417]; *In the Matter of Torchlight Fund LP* [2018 (1) CILR 290.

- the dominant intention of the company's directors was to give the applicable creditor a preference over other creditors.

In *re Weavering Macro Fixed Income Fund Ltd (in Liquidation)* the Cayman Islands Court of Appeal[115] and Judicial Committee of the Privy Council[116] considered in detail each stage of the test to be applied in identifying voidable preferences under section 145(1).

Giving a preference over other creditors means putting that creditor in a better position than it otherwise would have been.[117] If the company's dominant intention in making the payment or granting the security was to achieve a different purpose (for example, in good faith to pay an essential service provider) it might not be classed as a voidable transaction even if the collateral effect is to prefer the creditor in question. A dominant intention may be inferred by the court from the available evidence.

Importantly, a disposition made to a "related party" of the company (such as a person who has the ability to control the company or exercise significant influence) will be deemed to have been made with a view to giving a preference.[118]

A disposition that is set aside as a preference is voidable upon the application of the liquidator, who may ask the Grand Court to order the creditor to return the asset and prove in the liquidation for the amount of its claim.

Avoidance of dispositions made at an undervalue

Section 146 of the Companies Act provides that a transaction in which property:

- is disposed of at an undervalue; and

- with the intention of wilfully defeating an obligation owed to a creditor (that is, an intent to defraud)

is voidable on application of the liquidator.

"Undervalue" is defined to mean the provision of no consideration or a consideration which in money or money's worth is significantly less than the value of the property.

The burden of proof is on the creditor or liquidator (seeking to have the disposition set aside) to establish an intent to defraud.

The application must be brought within six years of the disposal.

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115 [2016 (2) CILR 514].
116 *Weavering* [2019 (2) CILR 245].
117 *Weavering* [2019] UKPC 36.
118 Companies Act, s 145 (2) and (3).

Fraudulent trading

Section 147 of the Companies Act deals with fraudulent trading.

If the business of a company was carried on with intent to defraud creditors, or for any fraudulent purpose, a liquidator may apply for an order requiring any persons who were knowingly parties to such conduct to make such contributions to the company's assets as the Court thinks proper.

Obligation to file for insolvency

There is no statutory obligation to file for insolvency and the Companies Act does not contain a prohibition on wrongful trading (that is, continuing to trade whilst insolvent).

Directors can, however, be made personally liable to the company for any losses which they cause to the company if they act in breach of their fiduciary duty to act in the best interests of the company.

In *Prospect Properties v McNeill*[119] the Grand Court held that where a company is insolvent, the directors' duty to act in the best interests of the company requires them to have regard to the interests of its creditors. It is in the interest of the creditors to be paid and it is in the interest of the company to be safeguarded against being put in a position where it is unable to pay.

When a company is in official liquidation, the official liquidator can pursue claims against the directors on behalf of the company (in the company's name) for breach of their fiduciary duty.

Time frame for completion

There is no set time within which a liquidation must be completed. The time taken to complete a liquidation depends on a number of factors including, but not limited to, the complexity of the issues and the nature and size of the assets.

Dissolution

At the completion of the winding up of the affairs of the company, the official liquidator applies to the Grand Court for an order that the company be dissolved.[120]

The company cannot be reinstated after dissolution.

[119] [1990-91 CILR 171].
[120] Companies Act, s 152.

Self-Assessment Exercise 4

Question 1

Name the three types of liquidation in the Cayman Islands.

Question 2

Over which companies does the Cayman Islands Grand Court have jurisdiction?

Question 3

Under what circumstances may a voluntary liquidation come under court supervision?

Question 4

In what circumstances may a company be wound up by the Court?

Question 5

How does any stay affect secured creditors?

Question 6

Describe the main avoidance of property provisions in the Cayman Islands.

For commentary and feedback on self-assessment exercise 4, please see APPENDIX A

6.4 Receivership

6.4.1 Grand Court Rules

Receivers may be appointed albeit they are not explicitly mentioned in the statutory provisions dealing specifically with insolvency (namely the Companies Act and Companies Winding up Rules). The Grand Court Rules (GCR) contemplate that receivers may be appointed by the Court for the purposes of collecting money (for example, rents) or to carry out some other act (for example, the execution of a contract or a document of title).

Order 30 GCR governs the appointment and duties of receivers generally.

Order 45 GCR (which deals with enforcement of judgments and orders generally) states that receivers may be appointed to enforce court orders for the payment of money.

Order 51 GCR also provides for the appointment of receivers by way of equitable execution. [121]

6.4.2 Segregated Portfolio Companies (SPCs)

Receivers and receivership orders are, however, specifically provided for by statute in respect of a particular type of Cayman Islands legal entity, namely the Segregated Portfolio Company.

An SPC is essentially a regular company which remains a single entity, but which is permitted to create separate portfolios for the allocation different types of assets and liabilities. Each portfolio is ring-fenced (by statute) from the assets and liabilities contained in other portfolios.[122] These companies are easily identified by the words "Segregated Portfolio" or "SPC" after their name.

If the Grand Court is satisfied that the SPC's assets attributable to a particular portfolio of the company are likely to be insufficient to discharge the claims of creditors in respect of that portfolio, it may make a receivership order in respect of that portfolio.[123] The role is analogous to a liquidator[124].

A receivership order must direct that the business and assets of, or attributable to, a segregated portfolio must be managed by a receiver specified in the order for the purposes of:

(a) the orderly closing down of the business of, or attributable to, the segregated portfolio; and

(b) the distribution of the segregated portfolio assets attributable to the segregated portfolio to those entitled to have recourse thereto.[125]

A receivership order:

(a) may not be made if the segregated portfolio company is in the process of being wound-up; and

(b) shall cease to be of effect upon commencement of the winding-up of the segregated portfolio company, but without prejudice to prior acts of the receiver or their agents.[126]

When an application has been made for (and during the period of operation of) a receivership order, no suit, action or other proceedings may be instituted against the segregated portfolio

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[121] This power derives from section 11(1) of the Grand Court Law (which states that the Grand Court shall possess like jurisdiction within the islands which is vested in the High Court of England) read in conjunction with Section 37(1) of the Senior Courts Act 1981 (England) which states the High Court may appoint a receiver in all cases in which it appears just and convenient to do so. For an example where receivers have been appointed, see *Scotiabank (Cayman Islands) Limited v Treasure Island Resort (Cayman) Limited* [2004=2005 CILR 423]; see also *TMSF v Merrill Lynch Bank and Trust Company (Cayman) Ltd* [2011] (1) CILR and *Y v R* (Jan 2018).

[122] Companies Act, s 216.

[123] *Idem*, s 224(1).

[124] *In the Matter of JP SPC 1 and JP SPC 4* [2013 (1) CILR 330].

[125] Companies Act, s 224(3).

[126] *Idem*, s 224(4).

company in relation to the segregated portfolio in respect of which the receivership order was made, except by leave of the Court (which may be conditional or unconditional).[127]

During the period of a receivership order, the receiver relieves the directors of their functions and powers in respect of the business of the SP.[128]

6.4.3 Use by creditors

Leaving SPCs to one side, the main relevance of receivers in an insolvency context is that receivership may offer an alternative course of action for certain creditors.

Receivers can be appointed without any court involvement pursuant to rights in a security instrument. For example, a holder of a fixed or floating charge can, if the charging document specifically provides for it, appoint a receiver over the company's charged assets if a debtor defaults on its obligations.[129]

The receiver will act under the powers set out in the charge document, which will typically include a right of sale. The receiver will generally realise the value of the charged asset and repay the creditor the amount of its unpaid debt.

In this scenario, the receiver is not supervised by the court and usually owes its duties to the creditor rather than the debtor company.

6.5 Corporate rescue

6.5.1 Introduction

Until very recently, the Cayman Islands legislative framework did not contain a specialised restructuring regime equivalent to the US Chapter 11 or the UK's administration procedure.

Notwithstanding the absence of such a statutory regime, the Cayman Islands managed to earn a reputation as a leading restructuring jurisdiction thanks to the ingenuity of local practitioners and the judiciary. The main technique that was used to achieve breathing space for the debtor, was to put the debtor company into provisional liquidation (PL) pursuant to Section 104(3) of the Companies Act. The PL order served to trigger a moratorium on claims against the debtor. The applicant would then explain to the court that the debtor company intended to negotiate and promote a compromise with creditors or members from within the provisional liquidation process.

Whilst practitioners will still need to be aware of the above technique, it will not be used for restructurings going forward. This is because, on 30 August 2022, the Cayman Islands introduced new legislation creating the concept of the "restructuring officer" (RO or CRO) which is akin to English administration or the USA's Chapter 11 proceedings.

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[127] *Idem*, s 226(5).
[128] *Idem*, s 226(6).
[129] See, eg, *Scotiabank (Cayman Islands) Limited v Treasure Island Resort (Cayman) Limited* [2004-2005 CILR 423].

Full details of the scheme can be found in the new Part V, section 91A-J of the Companies Act. Notable features of the new restructuring officer regime include:

- A company may present a petition to the Grand Court for the appointment of an RO on the grounds that:
    - It is or is likely to become unable to pay its debts; and
    - It intends to present a compromise or arrangement to its creditors (or classes of creditors)
- The petition may be presented by the directors of the company without a resolution of the shareholders and without there being any express power to present a petition in the company's articles of association.
- A moratorium (meaning that no suit, action or other proceedings, whether domestic or foreign, may be initiated or proceeded with without leave of the court) is automatically triggered upon the *filing* of the petition.
- The moratorium has extraterritorial effect.
- Secured creditors will continue to be entitled to enforce their security without leave of the court and without reference to the RO.

There continue to be parallels with the old PL technique:

- An RO must be a qualified insolvency practitioner (IP);
- A foreign practitioner can also be appointed to act together with a locally qualified IP;
- The RO's functions and powers will be set out in the terms of the court's order appointing them.

In urgent cases, an RO may be appointed on an interim basis (pending hearing of the petition) on such terms as the court thinks fit.

Once the RO is appointed, the restructuring may take several forms. It may involve a consensual deal or other informal work-out with creditors of the company. Alternatively, it may use a Cayman Islands scheme of arrangement (see immediately below). On the other hand, it might support a restructuring proceeding in a foreign jurisdiction (for example, an English scheme or Chapter 11 proceedings in the United States).

6.5.2 Schemes of arrangement

Historically, when restructurings were achieved via the appointment of PLs, it was very common for a scheme of arrangement to be used. One can expect schemes to remain popular under the new RO regime.

A scheme of arrangement ("scheme") is a court approved compromise or arrangement entered into between a company and its creditors or members or any classes of them. This will be familiar to students with knowledge of English schemes of arrangement.

The power to "scheme" a company derives from section 86 of the Companies Act (as revised).[130]

6.5.2.1 Some or all creditors of members

Such a compromise or arrangement may be proposed and agreed between a company and its creditors or any class of creditors, or between the company and its members or any class of members.

A scheme may, for example:

(a) restructure liabilities;

(b) reorganise share capital; and / or

(c) alter shareholders and creditors' distribution rights.

Debt for equity swaps are common. Pre-packaged sales are also possible but are less common in practice.

6.5.2.2 Who may commence the scheme?

The company, a creditor or a shareholder can commence scheme proceedings; however, scheme proceedings that are commenced by a creditor or shareholder require the company's consent.

6.5.2.3 Provisional liquidation, the restructuring officer and the moratorium

As stated elsewhere, the historic position was that it was only possible to obtain a court ordered stay if the company was in liquidation (which includes provisional liquidation). This meant that if breathing space from creditors was required to effect the scheme, the company needed to present a winding-up petition to the Grand Court and apply for an order appointing provisional liquidators prior to filing the scheme petition.

[130] For greater detail, see Practice Direction 2 of 2010.

Going forward, we can expect to see the appointment of an RO being used to secure a stay and for the appointment of an RO to be combined with an application for the company to be permitted to explore the viability of a scheme of arrangement.

6.5.2.4 Company management

It remains to be seen whether, and if so to what extent, existing management will continue to have a role in managing the company after an RO has been appointed. It can be expected that the Grand Court will determine which powers will remain with the directors (if any) and which will be vested in the ROs in much the same way that the Grand Court used to do when appointing PLs.

6.5.2.5 Approval procedure

The procedure for obtaining approval for a scheme of arrangement is governed by Order 102, rule 20 of the Grand Court Rules (GCR) and Practice Direction 2/2010.

After the filing of a scheme petition, there is a three-stage process for schemes:

(a) An application must be made to the Grand Court for an order that meetings of creditors or members be convened for the purpose of approving the scheme (the "convening hearing");

(b) The scheme proposals are discussed at meetings held in accordance with the convening hearing order and are either approved or rejected (the "scheme meetings");

(c) If approved at the scheme meetings, an application is then made to the Grand Court to obtain approval / sanction of the scheme (the "sanction hearing").

The detailed scheme documentation is distributed to all scheme participants and may also be advertised, depending on the circumstances.

The documentation will typically contain a mechanism for determining claims, post-sanction of the scheme, for distribution purposes.

6.5.2.6 Convening hearing

At this hearing, the Court will be concerned with issues of class composition, any jurisdictional issues, the adequacy of the scheme documentation and notice.

The Grand Court must be satisfied that the scheme document and supporting explanatory statement contain all the information reasonably necessary to enable the scheme creditors (and / or shareholders, as applicable) to make an informed decision about the proposed scheme.

6.5.2.7 Scheme meetings

This historic position has been that, in order for a proposed scheme to be approved, a majority in number (that is, over 50%) representing at least 75% in value of the creditors (or class of creditors, or members or class of members, as the case may be), present and voting either in person or by proxy at the meeting, must agree to the compromise or arrangement.[131]

Recent amendments to the Companies Act have, however, removed the "majority in number" requirement for **member** schemes (leaving the test for **creditor** schemes unchanged). The new test for member schemes is:[132]

> "If seventy-five per cent in value of the members or class of members, as the case may be, present and voting either in person or by proxy at the meeting, agree to any compromise or arrangement, the compromise or arrangement shall, if sanctioned by the Court, be binding on all the members or class of members, as the case may be, and also on the company or, where a company is in the course of being wound up, on the liquidator and contributories of the company."

If the necessary majorities are obtained, the scheme can proceed to the sanction hearing (see below).

In this way, it is possible for a debtor can "cram down" creditors (force dissenting creditors to accept the scheme of arrangement) within an accepting class, provided the threshold is reached. It also follows, however, that a scheme creditor or group of creditors may be able to block a scheme if they command enough votes.

6.5.2.8 Cross- / intra-class cramdown

At the convening hearing, the court may have placed creditors into different classes. If it has done so, all classes must vote to accept the scheme of arrangement for it to be sanctioned by the court. Therefore, there is no "cramdown" of the proposed restructuring on a dissenting class.

This lack of "cross-class cramdown" normally does not present a problem because, unlike Chapter 11 proceedings, most schemes in the Cayman Islands have very few classes (and often only one class) of creditors. In addition, secured creditors are generally treated as being outside the scheme since they can exercise their security rights at any time.

6.5.2.9 Court sanction

If it has the necessary creditor support, the compromise or arrangement must still be sanctioned by the Court before it is binding on all the creditors (or the class of creditors, or on the members of class of members, as the case may be), the company and its contributories.[133]

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[131] Companies Act 86 (2)
[132] *Idem*, s 86(2A).
[133] *Idem*, s 86(2).

A dissenting creditor (or shareholder) has the right to oppose the scheme at the sanction stage, although its options will be limited at that point.

The Court will be concerned with:

- compliance with the convening orders;
- whether the majority fairly represent the class; and
- whether the arrangement (having regard to the alternatives) is such that an intelligent, honest member of the class convened, acting in their own interest, might reasonably approve it.

6.5.2.10 Timeframe

Typically, it takes between three to six months from the filing of the petition to the approval of the scheme. In addition, prior to the filing of the petition, time may be spent negotiating the scheme with creditors and preparing documentation.

6.5.2.11 Trading claims

There is no statutory prohibition on the trading of creditor claims. Notice of the assignment would need to be given to the company.

6.5.2.12 Groups

As discussed above in relation to provisional and official insolvency, the Grand Court can take a pragmatic view in relation to group companies. In the restructuring context, therefore, schemes of arrangement may be co-ordinated to ensure efficiency and cost effectiveness.

6.5.2.13 Disposal of assets

If the company is under the control of a restructuring officer or provisional liquidator, the disposal of assets must be subject to Grand Court approval. Otherwise, the disposal of assets will be carried out by the directors and there are no restrictions to the use or sale of the company's assets (save for any applicable contractual restrictions).

Creditors may bid for the assets. There are no specific rules that govern bids by creditors; however, if the company is under the control of an RO or a PL, the sale will require approval of the Grand Court.

6.5.2.14 Funding a scheme

The process is funded from the company's assets and / or from any new money (sometimes referred to as debtor-in-possession or DIP financing) invested by way of debt or equity.

If the company is being schemed without an RO or PL, there is no statutory protection / priority afforded to rescue financing. Similarly, there will be no statutory protection / priority in the event the company emerges from court supervision but subsequently fails.

If, on the other hand, rescue financing is provided during the period in which an RO or PL is appointed, and the company is subsequently wound up without having emerged from the court-supervised rescue process (because no restructuring was ultimately approved), then the rescue financing is likely to constitute an expense of the RO or PL, thereby taking priority over most official liquidation expenses and all unsecured creditors' claims.

It is noteworthy that any such priority still does not trump any pre-existing security which had been taken over an asset (see commentary on the status of secured assets above).

6.5.2.15 Conclusion of scheme

The Grand Court must approve the terms of the scheme before it becomes effective and will not do so unless satisfied that it is fair.

A scheme of arrangement concludes after all the terms to which it relates have been complied with.

For practical examples of a scheme being used, see *In the Matter of Ocean Rig*[134] and *In the Matter of The Sphinx Group of Companies*.[135]

Self-Assessment Exercise 5

Question 1

What are the key features of the new restructuring officer regime?

Question 2

What is a scheme of arrangement? Is it possible for management to stay in place during a scheme?

Question 3

Is it possible to cram down dissenting shareholders?

For commentary and feedback on self-assessment exercise 5, please see APPENDIX A

[134] [2017 (2) CILR 495].
[135] [2014 (2) CILR 152].

7. CROSS-BORDER INSOLVENCY LAW

The Cayman Islands has positioned itself as a leading financial centre for international business. It is home to some 100,000+ companies, many of which conduct their business exclusively outside the Cayman Islands. As a result, most liquidations involve cross-border issues.

7.1 The Court's powers

The Grand Court's powers to make orders in support of foreign insolvency proceedings, are provided for in Part XVII of the Companies Act.

7.2 UNCITRAL Model Law on Cross-Border Insolvency

The Cayman Islands has not implemented the UNCITRAL Model Law on Cross-Border Insolvency, although most of the principles are followed (in the interests of comity).

7.3 European Union legislation

The Cayman Islands, despite being a British Overseas Territory, is not a member of the EU and therefore EU legislation does not apply.

7.4 Discretion

In the Cayman Islands, there are no threshold tests for the grant of assistance, nor are there automatic rights based on the centre of main interests (COMI) of the debtor.

Instead, foreign representatives must satisfy the Cayman court that it is appropriate for the court to exercise its discretion by granting the relief sought in the foreign representative's application.

7.5 Foreign bankruptcy proceeding

A foreign bankruptcy proceeding includes proceedings for the purpose of reorganising or rehabilitating an insolvent debtor.[136]

7.6 Ancillary orders

The Grand Court can provide the following forms of ancillary relief:[137]

(a) recognising the right of a foreign representative to act in the Islands on behalf of, or in the name of, a debtor;

(b) enjoining the commencement or staying the continuation of legal proceedings against a debtor;

[136] Companies Act, s 240.
[137] *Idem*, s 241.

(c) staying the enforcement of any judgment against a debtor;

(d) requiring a person in possession of information relating to the business or affairs of a debtor to be examined by and to produce documents to its foreign representative; and

(e) ordering the hand-over – to a foreign representative- of any property belonging to a debtor.

7.7 Criteria upon which the Court's discretion must be exercised

In determining whether to make these ancillary orders, the Grand Court is guided by matters which will best assure an economic and expeditious administration of the debtor's estate, consistent with:[138]

(a) the just treatment of all holders of claims, wherever they are domiciled, in accordance with established principles of natural justice;

(b) the protection of claim holders in the Cayman Islands against prejudice and inconvenience in the processing of claims in foreign proceedings;

(c) the prevention of preferential or fraudulent dispositions of property in the debtor's estate;

(d) the distribution of the estate among creditors substantially in accordance with the statutory order of priority;

(e) the recognition and enforcement of security interests created by the debtor;

(f) the non-enforcement of foreign taxes, fines and penalties;

(g) comity (mutual recognition and co-operation concerning legal decisions).

7.8 Treatment of creditors

The Cayman Islands is decidedly creditor-friendly. It takes a universalist rather than a territorial approach to cross-border issues.

In many countries, insolvency law is heavily influenced by the desire to prevent unemployment (meaning that the interests of creditors are often subordinated). In other countries, insolvency laws give local creditors preferential treatment at the expense of foreigners. In contrast, Cayman Islands insolvency law focuses upon the rights of creditors (and all such creditors are treated equally regardless of where they are domiciled).

This informal policy allows for a huge volume of capital markets and financial asset finance business to be placed through the Cayman Islands.

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[138] *Idem*, s 242.

7.9 Protocols

Cayman Islands legislation does not provide for protocols between the Grand Court and foreign courts.

However, the law does make provision for Cayman official liquidators to enter into international protocols with foreign officeholders to promote:

(a) the orderly administration of an estate of a company in official liquidation;

(b) the avoidance of duplication of work; and

(c) the avoidance of conflict between the official liquidator and the foreign officeholder.

Such protocols may allocate responsibilities between the Cayman liquidator and foreign officeholder in relation to, *inter alia* the:

(a) preservation and realisation of assets;

(b) pursuit of causes of action;

(c) exchange of information;

(d) procedures for the administration of the estate and reporting;

(e) adjudication of claims; and

(f) distribution of assets.

Relevant provisions include:

- the Companies Act Part XVII (International Co-Operation);
- the Companies Winding Up Rules O.21 (International Protocols);
- the Grand Court Act, section11A (Interim relief in the absence of substantive proceedings in the Islands); and
- the Grand Court's Practice Direction 1 of 2018.

International protocols agreed between a Cayman liquidator and a foreign officeholder must be approved by both the Grand Court and the appropriate foreign court or authority.

For an example of what such a protocol might look like, see *In the Matter of Trident Microsystems (Far East) Limited*.[139]

Self-Assessment Exercise 6

Question 1

How will the Grand Court decide whether to grant assistance to overseas insolvency proceedings (and liquidators)?

Question 2

Are protocols used? Are there any legal requirements?

For commentary and feedback on self-assessment exercise 6, please see APPENDIX A

8. RECOGNITION OF FOREIGN JUDGMENTS

In cross-border cases, the Grand Court adopts a co-operative approach to ensure an effective winding-up and the protection of the interests of its creditors, wherever those creditors are situated.

8.1 Treaties

The Cayman Islands has not entered into any international treaties for the reciprocal recognition or enforcement of foreign judgments, neither has the UK extended its ratification of any such treaties to the Cayman Islands by Order in Council (save for the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards).[140]

The Cayman Islands is not a signatory to the Hague Convention on the Recognition and Enforcement of Foreign Judgments in Civil and Commercial Matters.

8.2 Statute

The Foreign Judgments Reciprocal Enforcement Act (1996 Revision) does provide a statutory scheme for recognition and enforcement of foreign judgments but only where the country from which the judgment originates assures substantial reciprocity of treatment regarding the enforcement of Cayman Islands Judgments.[141] To date, the provisions of the Act have only been

[139] [2012 (1) CILR 424] at 437.
[140] The UK has the power to extend treaties because the Cayman Islands is a British Overseas Territory.
[141] Foreign Judgments Reciprocal Enforcement Act (1996 Revision), s 3(1).

extended to judgments from the Superior Courts of Australia. This procedure is governed by Order 71 of the Grand Court Rules.

To be enforceable, the foreign judgment must be:

(a) final;

(b) a money judgment; and

(c) made after the 1996 Act was extended to the relevant foreign country.

8.3 Common law

Given the limited application of the Foreign Judgments Reciprocal Enforcement Act (1996 Revision), the enforcement of foreign judgments is usually achieved by commencing a new action in the Cayman Islands based upon the foreign judgment as an unsatisfied debt or other obligation.

Such actions are conducted under the regular procedural regime for litigation in the Cayman Islands (that is, The Grand Court Rules).

Money and non-money judgments (including declaratory judgments) are enforceable at common law.[142]

The mandatory requirements for enforcement of a foreign judgment at common law are:

(a) the judgment is final;

(b) the foreign court had jurisdiction over the debtor;

(c) the foreign judgment was not obtained by fraud;

(d) the foreign judgment is not contrary to public policy of the Cayman Islands; and

(e) the foreign judgment was not obtained contrary to the rules of natural justice.

Once a local judgment has been obtained, the full range of domestic enforcement remedies are available.[143]

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[142] *Bandone v Sol Properties* 2008 CILR 301. The case confirmed that *in personam* judgments may be recognised and enforced through equitable remedies or, if required, under the principle of comity. The Court will have regard to the principles of fairness, mutuality and public policy.

[143] Iincluding the appointment of receivers under O.45 of the Grand Court Rules.

8.4 Limitation

A six-year limitation period applies both for common law enforcement and under the 1996 Act.

The period runs from the date of the judgment or, when there have been appeals, the date of the last judgment.

Self-Assessment Exercise 7

How can one enforce a foreign judgement in the Cayman Islands?

For commentary and feedback on self-assessment exercise 7, please see APPENDIX A

9. INSOLVENCY LAW REFORM

9.1 Insolvency Rules Committee

The Insolvency Rules Committee is established by section 154 of the Companies Act (as revised). It is responsible for making rules that may be necessary to give effect to the substantive law.

The Committee is comprised of the Chief Justice, the Attorney General and several respected practitioners (lawyers and IPs) in private practice. The Committee is therefore a useful tool in developing procedural change.

In addition, attorneys and IPs in private practice are instrumental in liaising with the legislature and recommending reforms to government.

Other developments in the law are judge-led (in keeping with the common law tradition of the islands).

9.2 The Companies Winding Up Rules 2018

Effective February 1, 2018, amendments were made to the CWR. Amongst other things, a new Part V was inserted into Companies Winding Up Rules 2018. Order 3 enhances the ability of a company to present a petition for its own winding-up.

9.3 Foreign Bankruptcy Proceedings (International Cooperation) Rules 2018 (the FBPR 2018)

Changes were introduced in February 2018. The FBPR 2018 is concerned with the procedures by which a foreign representative can be recognised in the Cayman Islands and seek the assistance of the Grand Court. The FBPR has been revised to provide greater clarity on these procedures.

9.4 Restructuring officers

The introduction of restructuring officers on 30 August 2022 via changes to Part V of the Companies Act is arguably the biggest development in recent years. It provides debtors with a global moratorium which is automatic upon the filing of the application to appoint the RO.

9.5 Judicial Insolvency Network (JIN)

The Cayman Islands is a member of JIN and has adopted the JIN Guidelines for Cooperation in Cross-Border Insolvency Matters (JIN Guidelines). See Practice Direction No. 1 of 2018 (PD 1/2018). Such guidelines have been designed to enhance communication between courts, insolvency representatives and other parties.

10. USEFUL INFORMATION

- Cayman Islands legislation: https://legislation.gov.ky/cms/;
- Cayman Islands Judicial and Legal Website: https://www.judicial.ky/;
- Cayman Islands case law: https://www.judicial.ky/online-public-register-portal-term;
- Cayman Islands Grand Court practice directions: https://www.judicial.ky/courts/grand-court/practice-directions;
- Cayman Islands Monetary Authority: https://www.cima.ky/;
- Cayman Islands Restructuring and Insolvency Association: http://risa.ky/;
- Cayman Islands Law Reform Commission: http://www.lawreformcommission.gov.ky/portal/page/portal/lrchome;
- Cayman Finance (a private association tasked with promoting the financial services industry): https://www.cayman.finance/;
- Cayman Islands Legal Practitioners Association (CILPA) https://www.cilpa.ky/.

APPENDIX A: COMMENTARY AND FEEDBACK ON SELF-ASSESSMENT EXERCISES

Self-Assessment Exercise 1

Question 1

On which legal system is the Cayman Islands system loosely based?

Question 2

To which court or courts may a litigant appeal an adverse decision at first instance?

Question 3

Which law or laws contains govern insolvency?

Commentary and Feedback on Self-Assessment Exercise 1

Question 1

England.

Question 2

The Cayman Islands Court of Appeal, the Judicial Committee of the Privy Council in London and (in rare instances) the European Court in Strasbourg.

Question 3

The Companies Act (as revised), The Companies Winding Up Rules (as revised).

Self-Assessment Exercise 2

Question 1

Name the common forms of security in the Cayman Islands for immovable property.

Question 2

Name the common forms of security in the Cayman Islands for movable property.

Question 3

How can a lender ensure that other people have notice of its secured position?

Commentary and Feedback on Self-Assessment Exercise 2

Question 1

Mortgage (legal or equitable), fixed charge

Question 2

Mortgage (legal or equitable, fixed charge, floating charged, pledge, lien

Question 3

File notice of the security with the centrally maintained registers if the property in question is land, a ship, an aircraft or a motor vehicle. For all other types of property, ensure that the Register of Mortgages for the debtor is clear before making the loan and updated with details of the charge after the granting of the loan.

Self-Assessment Exercise 3

Question 1

Which law governs personal bankruptcy in the Cayman Islands?

Question 2

Which debtors may be subject to the jurisdiction of the bankruptcy court?

Question 3

Name 5 acts or defaults which can be alleged by a petitioner as the grounds of a personal bankruptcy petition?

Question 4

Is all the debtor's property available to creditors?

Commentary and feedback on Self-Assessment 3

Question 1

The Bankruptcy Act (Cap 7) (1997 Revision).

Question 2

See section 2 of the law – persons present, resident, having a place of residence, carrying on business in the Cayman Islands.

Question 3

There are 12 acts of bankruptcy set out in the legislation.

Question 4

No, there are exceptions for the support of the debtor's family (see sections 100 and 137, for example).

Self-Assessment Exercise 4

Question 1

Name the three types of liquidation in the Cayman Islands.

Question 2

Over which companies does the Cayman Islands Grand Court have jurisdiction?

Question 3

Under what circumstances may a voluntary liquidation come under court supervision?

Question 4

In what circumstances may a company by wound up by the Court?

Question 5

How does any stay affect secured creditors?

Question 6

Describe the main avoidance of property provisions in the Cayman Islands.

Commentary and Feedback on Self-Assessment Exercise 4

Question 1

Voluntary liquidation, provisional liquidation and official liquidation.

Question 2

The Grand Court has jurisdiction to make (winding up) orders in respect of companies which are either:

(a) incorporated in the Cayman Islands;
(b) incorporated elsewhere but subsequently registered in the Cayman Islands;
(c) in respect of a foreign company which –
- has property located in the Islands;
- is carrying on business in the Islands;
- is the general partner of a limited partnership; or
- is registered under Part IX (a so-called "overseas company").

See section 91 of the Companies Act.

Question 3

Section 131 of the Companies Act states:

"When a resolution has been passed by a company to wind up voluntarily, the liquidator or any contributory or creditor may apply to the Court for an order for the continuation of the winding up under the supervision of the Court, notwithstanding that the declaration of solvency has been made in accordance with section 124, on the grounds that-

(a) the company is or is likely to become insolvent; or
(b) the supervision of the Court will facilitate a more effective economic or expeditious liquidation of the company in the interests of the contributories and creditors."

Question 4

Section 92 of the Companies Act states:

"A company may be wound up by the Court if-

(a) the company has passed a special resolution requiring the company to be wound up by the Court;
(b) the company does not commence its business within a year from its incorporation, or suspends its business for a whole year;
(c) the period, if any, fixed for the duration of the company by the articles of association expires, or whenever the event, if any, occurs, upon the occurrence of which it is provided by the articles of association that the company is to be wound up;
(d) the company is unable to pay its debts; or
(e) the Court is of the opinion that it is just and equitable that the company should be wound up."

Question 5

Secured creditors are not prohibited from enforcing their security (Section 142 of the Companies Act).

Question 6

Section 99 (dispositions of property post-commencement), section 145 (voidable preference), section 146 (dispositions at an undervalue), section 147 (fraudulent trading) and common law breach of fiduciary duty.

Self-Assessment Exercise 5

Question 1

What are the key features of the new restructuring officer regime?

Question 2

What is a scheme of arrangement? Is it possible for management to stay in place during a scheme?

Question 3

Is it possible to cram down dissenting shareholders?

Commentary and feedback on Self-Assessment Exercise 5

Question 1

Key features of the new restructuring officer regime include:

A company may present a petition to the Grand Court for the appointment of an RO on the grounds that:
- It is or is likely to become unable to pay its debts; and
- It intends to present a compromise or arrangement to its creditors (or classes of creditors).

The petition may be presented by the directors of the company without a resolution of the shareholders and without there being any express power to present a petition in the company's articles of association.

A moratorium (meaning that no suit, action or other proceedings, whether domestic or foreign, may be initiated or proceeded with without leave of the court) is automatically triggered upon the *filing* of the petition.

The moratorium has extraterritorial effect.

Secured creditors will continue to be entitled to enforce their security without leave of the court and without reference to the RO.

Question 2

A scheme is a court approved compromise or arrangement between a company and its creditors or members. The power derives from section 86 of the Companies Act.

If the company remains out of liquidation, the management stay in control. If an RO is appointed, management may remain in control subject to oversight by the RO. Each case will be fact specific.

Question 3

It is possible for the majority of shareholders in a class to outvote dissenters within that class, but it is not possible for a majority of classes to outvote a dissenting class. In other words, there is no cross-class cramdown available.

Self-Assessment Exercise 6

Question 1

How will the Grand Court decide whether to grant assistance to overseas insolvency proceedings (and liquidators)?

Question 2

Are protocols used? Are there any legal requirements?

Commentary and Feedback on Self-Assessment Exercise 6

Question 1

The Cayman Islands has not implemented the UNCITRAL Model Law, although regard is had to the principles. The criteria upon which the Court's discretion will be exercised is set out at section 242 of the Companies Act.

Question 2

There is no legislation governing protocols between courts. However, there is law on protocols between officeholders. These must be approved by the Grand Court.

Self-Assessment Exercise 7

How can one enforce a foreign judgement in the Cayman Islands?

Commentary and feedback on self-assessment exercise 7

At common law there are five requirements:

(1) the judgment is final;
(2) the foreign court had jurisdiction over the debtor;
(3) the foreign judgment was not obtained by fraud;
(4) the foreign judgment is not contrary to public policy of the Cayman Islands; and
(5) the foreign judgment was not obtained contrary to the rules of natural justice.

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